
(1958) 10 BOM CK 0006

Bombay High Court

Case No: Income-tax Reference No. 18 of 1958

Bhor Industries Ltd.

APPELLANT

Vs

Commissioner of
Income Tax, Bombay
City-I

RESPONDENT

Date of Decision: Oct. 8, 1958

Acts Referred:

- Income Tax Act, 1922 - Section 14(2), 18A, 23A

Citation: (1959) 61 BOMLR 578 : (1959) 35 ITR 748

Hon'ble Judges: S.T. Desai, J

Bench: Single Bench

Advocate: N.A. Palkhivala, for the Appellant; G.N. Joshi, for the Respondent

Judgement

S.T. Desai, J.

This reference u/s 66(I), made at the instance of the assessees, one of whom is Bhor Industries Ltd., Bombay, and giver others who are shareholders, raises certain interesting questions. The assessment years so far as the company is concerned are 1947-48 and 1948-49. The assessment year in respect of the shareholders is 1949-50. The Bhor Industries Ltd. was at all material times a private company limited by shares and incorporated in the erstwhile Indian State of Bhor. Its registered officer was situate at Bhor and it carried on business of dyeing, printing and bleaching cloth, proofing etc. For both the years 1956 and 1947 it was held to be "non-resident" in the then British India. It will be convenient to use the expression "British India" for taxable territories in our judgment. Holding that the company was non-resident in British India in either of the two years, the Income Tax Officer had to determine its total income and its total world income. The general meetings of the company were held in respect of those years at Bhor and the only dividends that were declared at those meeting aggregated to Rs. 2,580 and Rs. 1,140 for the two years respectively. In this judgment we shall refer to some facts only to serve as an illustration in appreciating the legal contentions raised before us. In 1946, the

total income of the company was Rs. 4,32,542. The income arising in the Indian State of Bhore was Rs. 2,24,542 and its total world income which would be the sum of those two items was Rs. 6,57,084 and the only amount that it paid out as dividend was Rs. 2,580. In substance and in effect the profits were kept undistributed and the shareholders of the private limited company were content with that position. The company was one in which the public were not substantially interested within the meaning of Explanation to section 23A. The Income Tax Officer, therefore, invoked and brought into operation the provisions of section 23A and made an order u/s 23A in respect of both the years. The dispute before the Income Tax Officer related to the contents of the order including proportionate quantum that could be included in the total income of the shareholders concerned for the purpose of their assessment for the year 1949-50. It will be convenient to go back to the illustration with which we started. In respect of the year 1946, the position regarding the income of the company was this. The total income, as already mentioned, was Rs. 4,32,542. The income that accrued in the Indian State of Bhore was Rs. 2,24,542 and the Income Tax and super-tax payable on the income of the company came to Rs. 1,89,237. The amount available for distribution had to be ascertained as required by section 23A and that worked out at Rs. 2,43,305 by deducting the amount of Income Tax and super-tax from the total income. The dividend declared by the company was only Rs. 2,580. Therefore, the undistributed portion which was deemed to have been distributed u/s 23A amongst the shareholders worked out at Rs. 2,40,725 by deducting Rs. 2,580 from Rs. 2,43,305. The position in respect of the year 1947 was slightly different but it is not material to go into that for the purpose of this reference. Substantially, the facts for the purpose of this reference in respect of both the years can be taken as the same in view of the nature of the arguments urged before us. At this stage, we are, as already mentioned, referring to the income of the company. Some time after the end of the previous year 1947, the State of Bhore was merged in the Province of Bombay in consequence of the States Merger (Governors' Provinces) Order, 1949. That Order came into operation on 1st August, 1949. On 31st December, 1949, came into operation the Taxation Laws (Extension to Merged States and Amendment) Act, 1949. By section 3 of the latter enactment the Indian Income Tax Act, 1922, as also the Indian Finance Act, 1949, were extended to all the Merged States. That section specifically provides that the two Acts "shall operate as if they had been extended to, and brought into force in, all the merged States on the first day of April, 1949." The effect of this was that, although the State of Bhore became merged in the then Province of Bombay as from 1st August, 1949, that being the date on which the assent of the Governor-General was given, the effect of section 3(2) was that the provisions of the Income Tax Act and the relevant Indian Finance Act, 1949, were brought into force in that State some months earlier, that is on 1st April, 1949. Section 60A was added to the Indian Income Tax Act to bring the law in harmony and by section 6 of the Taxation Laws (Extension to Merged States and Amendment) Act, 1949, the Central Government was empowered to make any exemption, reduction in rate or other modification in respect of the Income Tax in certain cases to avoid hardship and difficulties. We shall presently state the relevant provisions of the enactments of which we have made some mention. In exercise of the

powers conferred by section 60A, the Central Government made an order instituted "The merged States (Taxation Concessions) Order, 1949," and it is on the applicability, scope and the effect of paragraph 12 of the Order that the principal arguments before us have evolved. It is not necessary to set out in this judgment the relevant provisions of the States of Merger (Governors' Provinces) Order, 1949, or the Taxation Laws (Extension to Merged States and Amendment) Act, 1949, or any provision of the Indian Finance Act. The relevant part of section 60A is as under :

"If the Central Government considers it necessary or expedient so to do for avoiding any hardship or anomaly, or removing any difficulty, that may arise as a result of the extension of this Act to the merged territories or to the territories which immediately before the 1st November, 1956, were comprised in any Part B State or to Chandernagore the Central Government may, by general or special order, make an exemption, reduction in rate or other modification in respect of Income Tax in favour of any class of income, or in regard to the whole or any part of the income of any person or class of persons."

2. It will be seen that income and classes of income and income of any person or classes of person, previously, i.e., prior to 1st April, 1949, were not being touched by the Indian Income Tax law when it was brought into the scheme of the taxation prevalent in the whole country. That, therefore, was bound to result in certain hardships and difficulties and likely to give rise to anomalous situations. To obviate that and to give relief or exemptions, where it was fit and reasonable to grant exemptions, the Legislature empowered the Central Government to pass requisite orders. It may here be mentioned that the Order was to be the creature of the provisions of section 60A and nothing more. It could not operate beyond the ambit or matrix of section 60A and was not intended to do so. We make this observation at this stage because the whole brunt of the argument of Mr. Palkhivala is to the contrary. The provision of the Merged States (Taxation Concessions) Order, 1949, which is very strongly relied on by Mr. Palkhivala is paragraph 12 of the same. In the course of the arguments before us as also in the judgment of the Tribunal reference has been made to certain other paragraphs of that order. It will be convenient to quote those paragraphs :

"4. The provisions of paragraphs 5, 6, 9, 10 and 11 of this Order shall apply to only so much of the income, profits and gains included in the total income of an assessee as would, had he been resident in the taxable territories, have been exempt under clause (c) of sub-section (2) of section 14 of the Indian Income Tax Act, 1922, if the Act had not been passed.

5. (1) The income, profits and gains of any previous year ending after the 31st day of March, 1948, which is a previous year -

(i) for the Merged States assessment year 1948-49, or

(ii) for the Merged States assessment year 1949-50, shall be assessed under the Indian Income Tax Act, 1922, if and only if, such income, profits and gains have not, before the 1st day of August, 1949, been assessed under the State Law.

(2) Where the income, profits and gains referred to in sub-paragraph (1) have not been assessed under the State law, they shall be assessed under the Indian Income Tax Act, 1922, and the tax payable thereon shall be determined as hereunder -

(i) the tax on the amount of such income, profits and gains included in the total income shall be computed at the Indian rate of tax;

(ii) the amount of such income, profits and gains shall be computed under the State law and the tax thereon computed at the Merged States rate of tax;

(iii) the amount, if any, by which the tax computed under clause (i) exceeds the tax computed under clause (ii) shall be allowed as rebate from the first mentioned tax, and the amount of the first mentioned tax as so reduced shall be the tax payable.....

6. (i) The income, profits and gains of any previous year ending after the 31st day of March, 1948, which does not fall within paragraph 5 of this Order or of any previous year commencing after the previous year referred to in the said paragraph shall be assessed under the Indian Income Tax Act, 1922, but the tax payable on so much of the income as pertains to the period ending before the 1st day of August, 1949, shall be determined as hereunder -

(i) the tax on so much of such income included in the total income shall be computed (a) at the Indian rate of tax and (b) at the rate of tax in force in the Merged States immediately before the 1st day of August, 1949,...

12. The provisions of section 23A of the Indian Income Tax Act, shall not be applied in respect of the profits and gains of any previous year ending before the 1st day of August, 1949, unless the State law contains a provision corresponding thereto."

3. Section 23A of the Income Tax Officer features prominently in this reference and we shall set out here the relevant part of that section, as it stood before the section was recast by the Finance Act of 1955 (we are concerned with the section before the amendment) :

"23A. (1) Where the Income Tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for that previous year are laid before the company in general meeting are less than sixty per cent. of the assessable income of the company of that previous year, as reduced by the amount of Income Tax and super-tax payable by the company in respect thereof he shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the

payment of a dividend or a larger dividend that that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of the company of that previous year as computed for Income Tax purposes and reduced by the amount of Income Tax and super-tax payable by the company in respect thereof shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income :

Provided that when the reserves representing accumulations of past profits which have not been the subject of an order under this sub-section exceed the paid up capital of the company, together with any loan capital which is the property of the shareholders, or the actual cost of the fixed assets of the company whichever of these is greater, this section shall apply as if intend of the words "sixty per cent." the words "one hundred per cent." were substituted :

Provided further that no order under this sub-section shall be made where the company has distributed not less than fifty-five per cent. of the assessable income of the company as reduced by the amount Income Tax and super-tax payable by the company in respect thereof unless the company, on receipt of a notice from the Income Tax Officer that he proposes to make such an order, fails to make within three months of the receipt of such notice a further distribution of its profits and gains so that the total distribution made is no less than sixty per cent. of the assessable income of the company of the previous year concerned as reduced by the amount of Income Tax and super-tax payable by the company in respect thereof :

Provided further that this sub-section shall not apply to any company in which the public are substantially interested or to a subsidiary company of such a company if the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof.

4. Explanation - For the purpose of this sub-section, -

a company shall be deemed to be a company in which the public are substantially interest if shares of the company (not being shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits) carrying not less than twenty-five per cent. of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by, the public (not including a company to which the provisions of this sub-section apply), and if any such shares have in the course of such previous year been the subject dealings in any stock exchange in the taxable territories or are in fact freely transferable by the holder to the members of the public.

(2) The Inspecting Assistant Commissioner shall not give his approval to any order proposed to be passed by the Income Tax Officer under this section until he has given the company concerned an opportunity of being heard.

(3)(ii) Where the proportionate share of any member of a company in the undistributed profits and gains of the company has been included in his total income under the provisions of sub-section (1) the tax payable in respect thereof shall be recoverable from the company, if it cannot be recovered from such member.

(iii) Where a tax is recoverable from company under this sub-section, a notice of demand shall be served upon it in the prescribed form showing the sum so payable, and such company shall be deemed to be the assessee in respect of such sum, for the purposes of Chapter VI.

(4) Where tax has been paid in respect of any undistributed profits and gains of a company under this section, and such profits and gains are subsequently distributed in any year, the proportionate share therein of any member of the company shall be excluded in computing his total income of that year.

(5) When a company is a shareholder deemed under sub-section (1) to have received a dividend, the amount of the dividend thus deemed to have been paid to it shall be deemed to be part of its total income for the purpose also of the application of that sub-section to distribution of profits by that company."

5. The assessee carried the matter in appeal to the Tribunal and the Tribunal decided against them practically on all the points. The primary contention of the assessee company before the departmental authorities and the Tribunal was that it was entitled to claim benefit of the exemptions granted by paragraph 12 and the Income Tax Officer was not entitled to make any order against the company u/s 23A in respect of any of the two years. Another contention related to interest which the company was compelled to pay by reasons of the fact no advance payment of Income Tax had been made as required by section 18A of the Indian Income Tax Act. Here, the submission was that the company was not bound to pay any advance tax and not being bound to pay any advance tax, there could be no question of penalty. The argument was that in any event the interest which it had been compelled to pay would, by the language of section 18A, be equated with tax and that the amount of that interest had to be taken into consideration in computing the assessable income of the company u/s 23A.

6. The contention of the shareholder-assessee was that they also were entitled to the benefit of the exemption granted by paragraph 12 and it was also their contention that they were entitled to the benefit of the provisions of section 14(2)(c) under which in respect of income arising within any Indian State no tax was payable as laid down in that section.

7. Three questions have been referred to us by the Tribunal on this reference :

"1. Whether paragraph 12 of the Merged States (Taxation Concessions) Order, 1949, precluded the Income Tax Officer from making any order u/s 23A in the case of the assessee company in respect of its profits and gains of the previous year ended 31st December, 1946 divided by 31st December, 1947.

2. Whether in making an order u/s 23A in respect of profits and gains of the year 1946/1947 the assessable income of that previous year is to be reduced not only by the amount of Income Tax and super-tax payable by the company in respect thereof but also by the amount of interest charged to it in accordance with the provisions of section 18A ?

3. Having regard to the order passed by the Income Tax Officer u/s 23A in respect of the company's profits of the year 1947 and having apportioned the sum of Rs. 17,641 to the shareholder, Pushpakumar, as his proportionate share in the distribution made by the Income Tax Officer u/s 23A and having regard to the provisions of section 14(2)(c) , whether the said sum of Rs. 17,641 has been properly included in his total income for the purpose of charging it to tax ?"

8. Questions 1 and 2 relate to the assessment of the company for the two years 1946 and 1947. Question 3 relates to the assessment of the shareholders-assesseees for the assessment year 1949-50.

9. It has been argued before us by Mr. Palkhivala that the effect of paragraph 12 of the Merged States (Taxation Concessions) Order, 1949, to which we shall refer as "the Concessions Order, of 1949" which was promulgated u/s 60A of the Taxation Laws (Extension to Merged States and Amendment) Act, 1949, to which we shall refer as "the Extension Act", was that the company became exempt from the operation of section 23A of the Income Tax Act notwithstanding the extension of the Income Tax Act to Bhore State. If one confines the matters to the language of paragraph 12 alone, the argument at first blush seems attractive, but paragraph 12 cannot be read in isolation. It has to be read in its proper setting and particularly bearing in mind the provisions of section 60A of the Extension Act. The argument founded on the phrasing of paragraph 12 needs to be stated very briefly and it is that the provisions of section 23A could not be applied by the Income Tax Officer to the income of this company for the assessment years 1947-48 and 1948-49 (accounting years 1946 and 1947) because those were profits and gains of previous year ending before the 1st of August, 1949, and there was nothing in the as of the Bhore State which contained any provision corresponding to the provision enacted in section 23 A whereby a fiction of law was raised and income which was not distributed amongst them. The object of section 23A and the sound principle underlying it are obvious and it is not necessary for us to discuss the same. But the question is not of the object of that enactment or the principle underlying it but of its applicability of otherwise to the assessee company before us. Now, the argument of counsel touches every element mentioned in paragraph 12 but it ignores the most material consideration, the consideration which goes to the root of the matter, and that consideration is that paragraph 12 applied to any assessee in respect of any assessment year. The

application and scope of paragraph 12, as we already mentioned in passing, has to be gathered from the language of section 60A . Therefore, it is necessary for us to examine the language of section 60A . That section, as we have already mentioned, authorises the Central Government to grant exemption and reduction in respect of any income or classes of income or in regard to the income of any person or classes of persons. The crucial words of the section, it will be seen, are that the exemption or reduction which the Central Government is authorised to grant is in respect of a situation which may arise as a result of the extension of the Act to merged territories, which could only be after the date of the Extension Act, unless there was anything in the enactment itself to give it retroactive operation or it was required that it should have effect ex post facto. We have already mentioned that the Income Tax Act and the Finance Act were to be applied from 1st April, 1949, but that will have bearing on certain other questions.

10. The argument of Mr. Palkhivala is that section 60A contemplates removal of hardships as a result of the extension of the Act to urged States and it was to counteract the hardships that may arise not in respect of assessment year 1949-50 or subsequent years but even in respect of earlier years. It is urged by learned counsel that the words which appear after the word "exemption" - in favour of any class of income, or in regard to the whole or any part of the income of any person or class of persons - were unqualified and not restricted to Income Tax on income assessable for the year 1949-50 and subsequent years and the measure had, therefore, applied to any income and the tax payable on that income for earlier year and sub relief was in fact calculated to counteract the image of the extension of the Act to the merged States.

11. Now, at the very outset, it is necessary to be clear in one's mind as to what was the result of the extension of the Income Tax law of British India to the Merged States. It was that any income not within the purview of the Act, income of persons or class of persons unaffected or untouched by the British Indian Act, became taxable and what is essential to note is that it became taxable for and/or after the assessment years 1949-50. The exemption was to be for the benefit and relief of those who were hit by the Extension Act. Its object was that incomes which were otherwise not liable to tax, but the Extension Act made so liable, were to be given partial relief or even exemption. But, says Mr. Palkhivala, that is not the object of the Extension Act and that is not the effect of section 60A . Now, it will be seen from the facts which we have already stated that even before the enactment of section 60A the assessee company was liable to pay tax respect of its income in British India (taxable territories). The inevitable starting point must be - Is the exemption claimed in respect of income for the assessment year 1949-50 or any subsequent year ? If not, section 60A has not legislated for it and no question can arise of considering the operation of the Order. In our judgment, this must be so because the Order cannot embrace incomes which were not within the ambit of section 60A itself. To put it differently incomes which were not touched by the Extension Act were not to benefit by the exemption. What was legislated for was income for the assessment year 1949-50 and subsequent years. That, to our mind, is the plain meaning of this important provisions

of the Extension Act.

12. What we have already mentioned is sufficient to dispose of the first question. But another argument has been advanced before us by Mr. Palkhivala and that is quod the income of the assessee-shareholders. The question as formulated relates to the case of the assessee company in respect of its profits and gains of the previous years 1946 and 1947. There is no specific question before us in respect of the income of the assessee shareholders relating to the applicability and effect of paragraph 12 of the Concessions Order. But it is clear from the statement of the case itself that the assessee-shareholders also had asked the Tribunal, on the section 66 (1) application, to raise that question of law and it seems but only fright that question No. 1 should be reframed by us and answered. We shall reframe question No. 1 by dividing it in two parts. The first part will be as the first question reads at present and the second part of that will be :

"Whether paragraph 12 of the Merged States (Taxation Concessions) Order, 1949, precluded the Income Tax Officer from making any order u/s 23A so as to affect the assessee-shareholders in respects of their profits and gains for the assessment year 1949-50 ?"

13. It has been urged by Mr. Palkhivala that even on the construction we are inclined to put on section 60A and the view we are inclined to take on the application and effect of paragraph 12 of the Concessions Order the assessee shareholders have been taxed in respect of the assessment year 1949-50 and would be within the ambit of the section itself and the Order. In a broad general sense we agree with Mr. Palkhivala. It is said by Mr. Palkhivala that the shareholders were hit by the section 23A order although it was made in respect of the company's income for the years 1946 and 1947 which corresponded with two assessment year prior to 1st August, 1949, because, here the shareholders were being taxed for the assessment year 1949-50. The next step of the argument is that a shareholder whether resident or non-resident could claim benefit of paragraph 12 and ask for exception in respect of the assessment year 1949-50 and the sequitur, it is said, of this premise is that section 23A could not be applied to the case of these assessees. The primary liability u/s 23A , it is said, was of the shareholders. The profit was the profit of the company and the State law did not contain any provisions analogous to that contained in section 23A and it stood to reason, so the argument has run, that the shareholders in any even should have the benefit of the exemption. Here also at first blush, the argument sounds somewhat attractive but in substance it amounts to this that we must look only at the Order and read paragraph 12 in the context of the relevant provisions of the Order but not in the light of section 60A of the Extension Act and the meaning and scope of section 23A of the Income Tax Act. Section 60A , as we have already observed, is the very foundation of the Order of 1949, including paragraph 12 of the same and before we look at paragraph 12, we have to remember that the scope and ambit of the exemption granted by paragraph 12 has already been determined by section 60A . Therefore, even when applying paragraph 12 to the case of an assessee shareholders in respect of any "income of any person or class of persons" taxed by the

operation of Extension Act, we have to go back to the application and effect of that section itself and in the present content, the provisions of that section 23A of the Income Tax Act have to be read together. Paragraph 12 itself states that the provisions of section 23A of the Income Tax Act would not be applied in respect of the profits and gains of any previous year ending before 1st August, 1949. Mr. Palkhivala rightly agrees that the profits and gains of any previous year here must mean the profits and gains of the company and not profits and gains of the assessee-shareholders. The starting point of invoking the operation of section 23A is the profits and gains of a company, which profits and gains, it is to be ascertained, were or were not properly distributed as required by law. It necessarily follows that the profits and gains of the company must be profits and gains which are brought within the operation of Extension Act and paragraph 12 cannot be read in isolation or divorced from its setting. It is, however, argued that even if paragraph 12 has to be read in the light of section 60A and the context of that section, when it came to making a concession to an assessee-shareholders for the assessment year 1949-50 or any subsequent year, it was open to the Government to extend the relief and grant the exemption to all or part of any income of the assessee. To the difficulty raised by the language of section 60A, the answer of learned counsel is that to stress it would be adding words in paragraph 15. Reference has been made in support of this argument to paragraph 4 of the Order and it is said that where the Government wanted the operation of the Order to be limited, it has specifically so provided. This part of the argument in our judgment is not well-founded. To read paragraph 12 in the context of section 60A would not be adding anything to the language of the paragraph. It has to be read and given effect to only within the ambit of section 60A. There is another aspect of the same matter. It can be said that in a sense the shareholder does not come into the picture when paragraph 12 mentions profits and gains of any previous year ending before 1st August, 1949, because these profits and gains can only be profits and gains of the company and the profits and gains of the company which can give rise to any exemption or any relief are the profits and gains for the year 1949-50 and subsequent years. This is not to suggest that paragraph 12 has no applicability to the case of any assessee-shareholder. We are merely pointing out that this is another facet of the same question. Of course, paragraph 12 does apply to an assessee-shareholders but it can only apply to an assessee-shareholder within the ambit and scope of section 60A and not outside it. The result, as we see, is that at the assessed-shareholder, although he became entitled to claim any relief or exemption by operation of the Order made u/s 60A in respect of the assessment year 1949-50, the effect of paragraph 12 read with section 60A and section 23A of the Income Tax Act is that it was the undistributed profit of a company for the year 1949-50 and subsequent years only to which the exemption can relate.

14. The second question before us on this reference raises a very short contention and we have already indicated what that contention is. The argument is founded on the language of section 18A(8) which is as under :

"Where on making the regular assessment, the Income Tax Officer finds that no payment of tax has been made in accordance with the foregoing, provisions of this section, interest calculated in the manner laid down in sub-section (6) shall be added to the tax as determined on the basis of the regular assessment."

15. This section, relates to advance payment of tax. Learned counsel has relied on the words "shall be added to the tax as determined on the basis of the regular assessment." The brief argument is that by adding this amount to the tax, the amount became tax for the purpose of computation envisaged by section 23A . There is nothing in the language of section 23A which permits of any such artificial meaning being given to penalty interest nor is there anything which permits of any equivalence being established between the payment of penalty interest and tax and super-tax contemplated by section 23A . We may add that section 29 deals with the question of tax, penalty and interest as separate concepts.

16. The third question, which, according to learned counsel, is also an important question on this reference relates to the contention of the assessee-shareholders that they have always been and have contained to be entitled to the exemption give by section 14(2)(c) which at the material time was as under :

"Tax shall not be payable by as assessee.....

(c) in respect of any income, profits or gains accruing or arising to him within an Indian State, unless such income, profits and gains are received or deemed to be received in or brought into British India in the previous year by or on behalf of the assessee, or are assessable u/s 12B or section 42 ."

17. We are not concerned here on this reference with section 12B or section 42 . We have already mentioned that the operation of the Income Tax Act and the Finance Act, 1949, was retroactive from 1st April, 1949. Now relying on section 14(2)(c) the argument urged on behalf of the assessee-shareholders is that the effect of the Extension Act and the Order was not to deprive them of the benefit of section 14(2)(c) in any manner. It is said that the income which they derived as dividends could not be charged in their hands unless it was shown that it accrued in British India or is deemed to have accrued in British India or was brought into British India in the previous year. The argument proceeded that this is a case of a fiction of law created by section 23A. Dividend which may have been distributed could not be at the office of the company in Bhore State and since the income was to be deemed to have been distributed in the Bhore State, it was exempt from tax u/s 14(2)(c) , even though the assessee-shareholders were resident within British India. Though included in their total income, it was to be exempt from taxation and the shareholders would not have to pay tax on it by operation of section 14(2)(c) . It has been urged that the shareholder would be justified in saying that he should be put in the same position in which he would have been if 60% of the profits of the company had been declared as dividend. The shareholder would not have to pay tax in respect of the income

in British India by operation of section 14(2)(c). Reference has also been made to section 16(1)(a) and it is said that it relates only to rates and not to assessments. The argument here has centered round one point and that point is that what was to be regarded was not the law in force on 1st August, 1949, be the law in force in Bhore State on 1st April, 1949, and if that was the position, the application of section 14(2)(c) survived. Now, we have already pointed out that although the extension of the Income Tax Act to the merged States was by virtue of the provisions of the Extension Act, 1949, retrospective effect was given to the provisions of the Income Tax Act and the Finance Act, 1949, as from 1st April, 1949. Therefore, this argument does not survive. Learned counsel has also relied on what he has already submitted in the context of the first question before us. It is not necessary for us to deal with the same over again.

18. On the other hand, it has been argued by Mr. Joshi, learned counsel for the Revenue, that so far as undistributed profits are deemed to be distributed by virtue of an order made u/s 23A, there is no question of accrual. The deemed income is to be included in the total income and the point of exemption is not material in this context because the inclusion is by virtue of section 23A itself. Then, it is said that even assuming that the place of accrual was of relevance, it became immaterial because Bhore State had become part of British India (taxable territory) for the purpose of application of the Income Tax Act as from 1st April, 1949. It is not necessary for us to deal with the first argument of Mr. Joshi. The second argument meets the case. In our opinion, it is not permissible to the assessee-shareholders, in view of the relevant provisions of legislation to which we have already referred, to claim that they were entitled to the benefit of section 14(2)(c).

19. We have so far not referred to an argument of Mr. Palkhivala and that argument is, if we may so describe it, *de hors* the Extension Act. It turns on the construction to be put on paragraph 4 of the Order of 1949. Succinctly stated, the argument has been that the paragraph gave benefit of the relevant exemptions both to the assessee who were non-resident in the taxable territories and those who were residents in the taxable territories. The identical point was raised before this court in Income Tax Reference No. 28 of 1955 decided by Chagla, and Tendolkar on 20th February, 1956, in a matter, which, we are informed has been carried to the Supreme Court. In that case, this very contention was negatived and we are bound by that decision. It is not necessary for us to examine this argument of Mr. Palkhivala.

20. Our answer to the first part of question 1 will be in the negative and to the second part of the same question will also be in the negative.

21. Our answer to question 2 will be in the negative.

22. Our answer to question 3 will be in the affirmative.

23. Assessee to pay the costs.

Reference answered accordingly.